The Canadian Chartered Accountant

OFFICIAL ORGAN OF

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

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THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

ANNUAL MEETING

The Forty-first Annual Meeting of The Dominion Association of Chartered Accountants will be held at the Royal York Hotel, Toronto, Ontario, on Tuesday and Wednesday, 17th and 18th August 1943, for the reception of reports, election of officers, amendment of by-laws and for such other business as may be brought before the meeting.

The Council will meet on Monday, 16th August, and conclude on Tuesday, 17th August.

Kris A. Mapp,
President.

Toronto, Ontario,
1st June 1943.

Editorial Comment

The Balance of Income and Outgo

At this particular time of the year, when tax deductions or instalments for 1943 have taken effect, when the payment of 1942 balances is imminent, and when we have been further imprest by the Victory loan campaign, it may be offensive to even suggest that we have too much money to spend. Nevertheless the open markets, in so far as they still exist, supply overwhelming evidence of a purchasing power in excess of the available amount of goods and services. This reminds us that we are living in a time when history is being made, not merely in the sense that the present war is the most widespread that the world has ever known, but also in the sense that the direct controls over our economic affairs are being tried on a scale never before attempted in modern times. The function of the market place, in which a fluctuating price achieved the balance between demand and supply, has been largely abandoned. We do not allow manufacturers to outbid one another for tin, or rubber, or any other raw material, nor do we allow housewives to stock coffee and sugar according to their respecting ability to pay. Through industrial controls we try to apportion materials into the most useful channels, and through consumer rationing we set a maximum on what each individual may purchase. On top of these specific controls in Canada is the general price ceiling—in so far as it may still be effective.

But if we want proof of the real situation, we have only to consider the fact that practically all controlled or rationed goods are purchased up to the allowed limits. Clearly, if financial affairs were as stringent as are the controls, there would be some items which we would choose not to buy. And the rapid absorption of unrationed goods, which in Canada still include clothing, furniture, jewellery, and some foods, shows conclusively that purchasing power is still in excess of supplies. In Great Britain and the United States, where the control programs fall somewhat short of the general price ceiling attempted in Canada, the same situation is revealed in the phenomenon of sky-rocketing prices for unregulated goods.

The obvious conclusion is that, if any of our govern-

ments ever seriously intended to keep purchasing power in balance with available goods, and thereby keep prices stable, not one of them has really succeeded in doing so. The trend of prices is definitely upward in every nation. To say that taxation has gone the limit, and that we will now proceed to drain off the surplus money through borrowing, is rather a weak answer, especially when a surplus of money still remains in circulation. If money management, which is certainly in effect in Canada as in other nations, can not achieve this now, what chance is there for it doing so in the future? And if we are found lacking in this relatively narrow task of controlling money and prices, what chance would we have of achieving success in a fully managed economy, under which our very bread and butter would depend upon a proper balancing of demand and supply? The economic lessons of the war will be useful if they prove to the public that the state, even with all the power granted to it in wartime, and all the patriotism of the people to back it up, itself has its limitations, and that the provision of the things that people want to consume is much too intricate a task to be fulfilled on rigid lines.

The 1943 Tax Amendments

The 1943 tax amendments have now been given the Royal assent. They will be printed and distributed by this Association, in accord with the practice of recent years. From the limited scope of the budget, it was not expected that the changes would be very radical, and this is the case. The Ruml idea has survived to the extent of half of the 1942 earned incomes and the smaller investment incomes, but those who are burdened with large investment incomes must pay in full either now or on their decease, so that they are reminded, more than ever before, that both death and taxes are inevitable. Along with this concession to the pay-as-you-go plan, there is a recasting of instalment dates and of the whole process of estimating one's income in advance. The present year, unfortunately, witnesses the intermingling of two conflicting ideas, the older of which dealt with income as a sum which could be accurately computed after it had

been accumulated and therefore assessed accordingly, and the newer of which views income as something which must be taxed at its very inception so that only the final adjustment is left until the completion of the year. As individuals, therefore, we find ourselves paying 1943 taxes long before we have finished paying those of 1942, and even before we have had time to reckon how much we still have to pay on account of 1942. The problems of corporate taxation are equally complicated.

It is unfortunate that, in spite of public demand for simplicity, and the government's own desire for a workable and efficient procedure, all of our efforts seem to leave us in a maze of forms, dates, rates and exemptions. We deceive ourselves with the mirage of next year, forgetting that next year will bring its own complications. Of course it makes business for accountants, but no one can accuse accountants of doing the making. The fact is that taxation is engaged in such a struggle against time and circumstance that it does not stay put for more than a fleeting moment. It is after the rabbit, but is always a jump behind.

War Risk Insurance

Though only a few months ago a Japanese invasion of our west coast was considered a serious threat, and of course such a possibility can not yet be ignored, nevertheless the hazard of an invasion from any quarter has diminished with the growing offensive power of the united nations. Likewise the danger of effective bombing has also decreased, even though a casual venture of this type is always possible. This trend of the war, which we fondly hope will continue, makes a brief review of war risk insurance interesting just now. One may reasonably expect that, unless there is a setback, property owners will be less concerned, perhaps even to the extent of carelessness.

In response to inquiries, figures were recently tabled in the Senate showing that from the inception of the scheme in Canada in 1941 up to the end of February this year, a total of $1,851 millions of insurance had been placed, with premiums of $4,355,932. Apart from pointing out that values of buildings and other property improvements are several times this amount of insurance, so that on the whole property owners were far from panic-stricken, one can hardly comment upon the figures, because there is nothing with

which to compare them. The most interesting feature is the wide variation in the response by provinces. The biggest demand was in British Columbia, which actually took 30 per cent of the insurance, though it is estimated to have less than 10 per cent of the national wealth. Curiously enough, Nova Scotia responded in about the same degree, taking nine per cent of the insurance against a wealth ratio of about three per cent. New Brunswick, Nova Scotia and Quebec took just a little more than their wealth ratios. The other provinces were less interested.

Of course war risk insurance, as a salesmen's proposition, is under something of a cloud. Ordinarily the premium is regarded as a business expense, and deductible for income tax purposes, but not so in the case of those individuals or corporations who are subject to excess profits tax, who can deduct only 40 per cent of the premium, and who therefore have to stand the remaining 60 per cent as best they can. The Dominion government has what it deems to be adequate reasons for this policy, and it is not our intention to dispute them here. Nevertheless the fact remains that a substantial though concealed levy has been made upon a large number of those property owners in the more exposed sections of Canada who considered the risk of war damage sufficiently imminent to warrant coverage.

A Successful Booklet

When arrangements were made some months ago by The Canadian Chartered Accountant for a series of articles designed to assist in staff training, and the interest shown in these articles as they were being published led us to have them reprinted in booklet form, we builded better than we knew. The booklet was entitled "Audit Procedure for the Junior Audit Clerk" and was announced in our April issue, when the final article of the series was published; the entire supply was quickly exhausted. The material was particularly useful under present conditions, when many new staff members, some of whom do not aspire to full professional training, have to be brought quickly to the point where they can do some effective work. We regret having to advise many inquirers that the booklets are no longer available.

CROWN MUNITIONS COMPANIES

By Watson Sellar, Auditor General of Canada

(An address at the annual dinner of The Society of Chartered Accountants of The Province of Quebec, 18th March 1943).

LIKE most boys reared in rural Quebec, I have a fondness for political controversy. Issues, I have found, are rarely as interesting as the strange and unexpected quirks of human nature which they bring forth. It was once my good fortune to work under a gentleman who had, to an unusual degree, an aptitude for valuing group and mass psychology. He gave it no such title. In his language it was "feeling the air". James A. Robb meant and means much to me. He taught me many lessons; one was—Never scare the horses by the people on the band wagon! There are practices in this war which we individually resent. There are some we passively accept because we feel it is the patriotic thing to do. There are others which are taken as logical and wholly desirable. In this last class the companies created by the Minister of Munitions and Supply have found a place. The fact that they have not figured to any degree in public controversy is an interesting by-product of the war. They have established, and the public apparently is willingly accepting, the principle that corporate management can be substituted for departmentalism without abuses resulting. I do not think any such plan could have been applied twenty-five years ago. As we recall the last war, we think in terms of individualists, of suddenly acquired, or the further accumulation of, great wealth. We have not changed as a people, but the general development of corporate management has created new standards of valuation. Security and continuity of the enterprise are regarded as more important than quick gains.

In this war, industry is directed mainly by salaried executives who plan to retire some day, with their places being taken by others along the executive line. Gone are the days when an owner saw no future for the business if he did not have a son to succeed him. Gone also perhaps is the fear of a board of directors being charged with a phase of public administration. If I am right, is it not a hopeful sign? Does it not mean that the way is being paved whereby the public may profit from the talents and experience

of the executive group that has taken the place of those forcible old gentlemen whose mere association with a public plan was sufficient to raise a cloud of suspicion with respect to the *bona fides* of the whole thing?

The Minister of Munitions and Supply has now twenty-four companies. The annual business of the nine among them which are engaged in purchasing and merchandising currently is at the rate of 350 millions a year; that of the ten manufacturing companies 140 millions, while the administrative companies cost about 2 millions.

How the Companies Originated

The story of the founding of these companies is bound around the memory of a good friend of many of us—the late Gordon Scott. I do not feel I am robbing others of credit when I hold that he was the originator of the form in which they were developed. It came about in this way. Early in 1940 he began pressing the need for Canada to hold in North America substantial reserves of silk and raw rubber. Others agreed; the question was how to go about it. There were obvious objections to the government operating openly—policy, bargaining, contracting and paying were involved. Almost simultaneously two other problems developed: first, that of managing the explosive plants the United Kingdom government planned to create, and secondly, the tooling of Canadian industry. The crux to a solution was to find a way which would avoid those delays which are inevitably associated with any large enterprise, public or private, without the weakening of the principle of ministerial responsibility to parliament. The plan adopted was the creation of a Crown company for each special activity, with the minister as the exclusive shareholder. There was parliamentary authority for this. The British Act, from which our Munitions and Supply Department Act was copied, made provision for companies, and this was carried into the Canadian Act.

Applications for incorporation were made in the usual way to the Secretary of State. Charters were obtained and by-laws adopted. Outstanding men in their respective fields agreed to act as presidents. Representative boards of directors were recruited. Qualifying shares were issued to the directors—each endorsing his share and depositing it with the secretary of the department. Enough shares were

also issued to the Minister to permit him, as shareholder for the Crown, to outvote all others. The companies and the Crown signed agreements which outlined the work to be performed and the powers delegated. The agreements are, however, subject to one general condition—the Minister may exercise whatever control he considers necessary over the affairs and operations of the company, and any failure on the part of the company to carry out his orders is cause for cancellation.

Accounting Differences

The outstanding difference between the financial statements of the companies and those of ordinary corporations is the treatment of fixed assets. A Crown corporation does not own its lands, buildings and machinery. These are provided rent free by the government, the cost being charged to the department's expenditures for the year. In other words, the investment is liquidated as a current expenditure. The public accounts of Canada for many years have not treated physical properties of this nature as assets. Therefore, these capital assets do not appear in the government balance sheet. The same practice applies (1) to the advances made to the purchasing companies, that is, to a company which, to a greater or less degree, acts as a purchasing agent, and (2) to working capital advances made to the operating companies. The Department of Munitions and Supply takes the view that the inventories in the hands of both the purchasing and operating companies may not be readily realizable at the cessation of hostilities, and, in consequence, their being treated currently as assets might be open to question on various grounds.

The advances to the merchandising companies are primarily to secure and deal in commodities for which there is usually a good demand at all times. Therefore, the liability of each of these companies to the government of Canada is reflected in the Dominion's balance sheet, because the inventories being readily convertible into dollars, the risk is mainly restricted to possible fluctuations in values.

At the commencement, the companies were placed in funds by means of accountable advances, with all company receipts being deposited to the credit of the Receiver General of Canada. The plan was not entirely satisfactory. Consequently, the Crown now provides working capital ad-

vances. The companies retain all receipts, but whenever the Minister is of opinion that a company has a larger bank balance than is necessary for its purposes, a recovery on working capital account is made to the Receiver General.

Auditing Procedure

The Auditor General is named auditor of the companies by the Department of Munitions and Supply Act. Periodic examinations of accounts are made throughout the year and reports are submitted to the Minister of Munitions and Supply in his capacity as minister answerable to parliament for the companies. These reports deal with both finance and administration. They are informal in character and could result in friction developing between the audit office and the managements, were it not that the universal desire of the boards of directors is to make certain that everything is done in a way which will commend itself to the people of Canada. At the year-end, the audit is completed and certificates given in accordance with the provisions of the Companies Act. In addition, a summarized report of the accounts is published in the report of the Auditor General to the House of Commons. The companies hold annual meetings, when the auditor's report is one of the matters on the agenda.

Operating and merchandising companies seek to be self-supporting. Some do better than that, but they do not pay income tax. The reason is that they are regarded as special branches of the department which have been organized to perform a public service—the Crown takes all in any event. But if a time comes when any one of them makes a real profit, and it is in competitive business, there is no prohibition against the company being treated in the same manner as is its competitor.

Results of the Plan

Based on nearly three years' experience, I feel the Crown company plan has proven efficient and economical. The Crown has been able to secure the services of outstanding business executives; men who would not have served happily under other circumstances. As a class, these gentlemen regard their work as an act of public duty. They have given freely of their time. They have kept costs well under control and the companies are producing worth-while re-

sults. Let me enlarge on this by selecting one company from each of the groups.

In the administrative group, Allied War Supplies Corporation is the pioneer. Mr. Harold Crabtree has been the president from the beginning, and I venture the surmise that since that day more dust has accumulated on his old desk than on that in the Allied office. The corporation was called upon to administer the construction programmes for the various explosive and shell filling plants; then negotiate operating contracts for the minister, and ultimately supervise the production programme. The management deals with contractors and operators and carries out the orders of both the Canadian and United Kingdom governments. It has been so successful that you rarely see the name mentioned in the press, which, in public administration, is about as good a yardstick to measure competence as you can find.

The first two trading companies had headquarters in Montreal. Fairmont has since transferred its offices to Toronto, so I will refer to Citadel Merchandising Company. The function of this company was and is to acquire for war plants generally whatever machinery as is needed. It was not a case of inviting salesmen in. Instead, by negotiations with the United States government, and by making arrangements with United States manufacturers, the management of Citadel had to get Canadian machine requirements to the top of lists. Canadian production had also to be developed. And, what was equally important, the deliveries from Canadian and United States' plants had to be spotted so that the machines went to the munitions plants most in need of the equipment. May I illustrate the success achieved by a personal reference to Mr. Thomas Arnold, the president. Like many civil servants, I have contacts with members of the public service in other governments. One has remarked that to them in Washington the administrative technique in Canada offers interesting comparisons. I paraphrase him: You funnel everything in the democratic way through your cabinet of ministers, who delegate application so that one man or agency can decide and act. Here in Washington one has to go from committee to committee and sometimes spend weeks co-relating decisions; no one being exactly sure of his powers to decide.

Now, when a Canadian tooling proposition comes up, your Mr. Arnold and a couple of others call. They state what they want, why, and what they are prepared to do. They produce credentials and sign on the dotted line. They can do in hours where it sometimes takes us weeks. Perhaps my friend sees the grass too green across the fence, but I think he had a point. From the Canadian angle, the risk in his observation was that the president of Citadel Merchandising might exceed his powers. So it is only fair to add that audit officers have invariably found that the president and the board of directors of Citadel have sought to adhere strictly to the spirit of such instructions as are given by the Department of Munitions and Supply.

The production companies operate a capital investment of over 40 millions in plant, equipment and supplies. The largest is Research Enterprises. Its origin is to be found in the need for optical glass and special equipment. It had to co-relate its development with the research of scientists, the ever-changing requirements of the service forces and the closely guarded formula of other countries. For these reasons and because experimental losses might be large, the venture was obviously one where a Crown undertaking was best suited. It started from scratch. Two short years ago it had neither buildings nor skilled workmen. Now its monthly production runs into millions of dollars. Lt. Colonel Phillips, the president, devotes his full time to the work. To my mind, Research Enterprises is one of the amazing contributions to the war, because of its size, the novelty of its product, the limited experience on which operation plans could be built and because the directorate's sole reward can be the satisfaction of a job well done. The company is, in the eyes of the Crown, a contractor. It enjoys no special privileges or benefits. It is required to compete with industry for its workers. But, as it does not own its plant, it is required to bill the Crown at cost.

Administrative Features

From the viewpoint of public administration, all of these corporate bodies are interesting experiments. I have particularized only with respect to a few. One could talk for hours on the work of the twenty-four. Statutory bodies have long been used by governments, but these munition companies mark a further development, because their

powers are not regulated by a special act. One in fact, the Toronto Shipbuilding Company, operates under a charter granted by the Province of Ontario. Administratively, the companies are noteworthy from at least two angles. First, because they may contain the germ of a possible solution to certain problems where the constitutional rights of the national and provincial governments make difficult the applications of rules of jurisdiction. Secondly, because they demonstrate that the standards of commercial enterprise are not incompatible with those regulating public administration. Regarded in this aspect, I feel that the scheme would never have worked had there not been give-and-take on both sides. To my way of thinking the administrative skill of the Honourable Mr. Howe, in distinguishing between what is public policy and what is corporate application, has meant the difference between success and failure of these ventures.

Future of the Companies

As to the future of these companies, no opinion need be formed. They are war enterprises. Some may have a post-war place in the economy of Canada; others have none. But either they or a new scheme of bodies have a place in the planning for the peace. Canada has poured many hundreds of millions into plant, machinery and supplies. The day will come when a diversion to civil needs can take place. That, I submit, cannot wisely be done by hanging out an auctioneer's banner and knocking down plant, machinery and stores inventories, in all their varied categories, to the highest bidder. That could prove disastrous to Canadian economy. It might have a distressing effect on many communities. By creating unfair competition, it could bankrupt long established and well-managed concerns of many kinds. Uncertainty of work and of wages might be the plight of many now producing munitions or wearing the King's uniform. Canada has no place for vultures in the peace; nor can it support uneconomic enterprise. Sometimes the knife of the surgeon will be necessary; in other cases the treatment will be one of healing care. The principles of policy have to be determined by Canada as a whole. The application involves the breakdown of size, the classifying of remedial action, and the vesting of responsibility for action in those best suited to assume the tasks. There

is a place for departmentalism and there is another for corporate direction. For example, I think that even at this stage much may be said in favour of vesting all of these assets in a Crown corporation whose balance sheet would clearly reflect the holdings and whose records would chronicle the disposition thereof.

As I said at the beginning, this is an age of corporate enterprise—a species of public administration. The working of the Crown corporations has demonstrated that it is possible for all to get together and build. Is there any reason why we should not do the same thing when it comes to recasting our industrial fabric? I think we can, if each holds to his place, plays his part and respects the legitimate aims of others. Gentlemen, today your profession is a part of the war effort; in the period which lies ahead you have a still greater responsibility to assume. No solution for the recasting of our enterprises is a true solution unless it is founded on solid facts, and the profession of accountancy exists to sift records to make certain the facts.

SOME OBSERVATIONS ON THE LIMITS OF THE FUNCTIONS OF AUDITORS

By A. Ian Fleming, Chartered Accountant, Montreal

THE functions of an auditor can be wide and varied depending on the terms of his engagement and the wishes of his client. It is not the purpose of this article to discuss special duties which an individual client or a client consisting of a firm of partners, may impose upon auditors in laying down the scope of the audit. It is hardly necessary to state that in such cases the terms of the engagement and the scope of the audit should be kept continually in front of the auditor from year to year.

In this article it is the case of the auditor of a limited liability company that is under review. The auditor's duties in this instance are laid down by the act under which the company is incorporated, though these may be enlarged in cases of companies the shares of which are in the hands of a few individuals or members of a family who are actively engaged in administering the company and are in personal touch with the auditors.

Where no special duties are imposed, the auditor's duties

are governed by the act concerned, in most cases by the Dominion Companies' Act. Section 120 of that Act requires that the auditor's report shall state whether or not he has obtained all the information and explanations he has required and whether, in his opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of his information and the explanations given to him and as shown by the books of the company. (This is similar to the British Companies' Act.)

This requirement is the basis of the auditor's function and the scope of the audit is determined with a view to the auditor being able to make such a report.

Mainly a Record of Facts

It has become accepted practice that the balance sheet and financial statements reflect an historical record of the company's financial transactions. A few years ago there was some advocacy (through the medium of *The Accountant* of England) of a change in this practice whereby the financial statements should reflect the capitalized earning power of the company. Fortunately this suggestion gained little support in the accounting profession. It is important that accountants retain a clear conception of the difference between the presentation of financial results (as revealed in the balance sheet of today) and estimates of capital value, which usually depend upon anticipated future earnings.

The accountant employed as an auditor is concerned with the presentation of financial results, and these are for the most part questions of fact and historical record. It is true that, due to the need of presenting financial statements at intervals of a year, it becomes necessary to use judgment and opinion in determination of the accrued portion of open and uncompleted transactions which should be reflected in the year's results and expenditures made, the benefits of which will be felt over a longer period; examples are inventories on hand, depreciation (which is, after all, only the partial expiry of a deferred charge in the shape of outlays on capital assets which take a comparatively long time to be fully amortized) and such items as expenses of an advertising campaign, development expenditures, etc. However, the use of estimate or opinion is kept to an ab-

solute minimum, and facts are adhered to as much as possible.

The Shareholder's Viewpoint

The shareholder is provided with the financial statements drawn up on the foregoing principle, and on the basis of the figures, and his general or special knowledge of economic or trade factors surrounding the company, he makes his decision whether to buy, sell or retain shares.

The shareholder or prospective shareholder may, and often does, use the services of an accountant to aid him in forming his opinion of the value of his shares (and, it follows, the value of the enterprise). In this case the accountant is serving in an entirely different capacity to that of auditor. He becomes either a valuator or investigator, and he may be called upon to make a report for a prospectus for a share issue. The accountant then governs his actions by very different principles. The focus of his attention is not only on past earnings but on future earnings and factors which can be seen to affect future earnings. He must call attention to such factors.

A recent contributor to *The Canadian Chartered Accountant* suggested that in cases where the residual depreciable value of machinery for income tax purposes was, for certain reasons, much less than the value in the financial statements, the auditors should call attention to the difference in their report on the basis that the taxable profits would lose the depreciation deduction sooner than the accounts would indicate and the future earnings would suffer correspondingly.

In the opinion of the writer this is the thin end of the wedge and opens up numerous other questions of a similar nature. For example, should the auditor of a gold mine refer to the fact that the ore resources will be exhausted in eighteen months' time? Should the auditor of a firm of contractors refer to the fact that a particularly large contract will soon be completed and no other similar contract is in sight? Or, where a concern has been fortunate enough to secure its plant at bargain prices with consequent low depreciation write-offs today but is faced with an early prospect of higher depreciation due to impending big replacements, should the auditor draw this to the attention of shareholders in his report?

The writer believes that these are matters for the directors of the company to report to the shareholders. An interested shareholder should ask questions on these points at the annual meeting, if they are not dealt with in the directors' report. It might be wise for an auditor to report to the directors a situation regarding depreciable capital assets such as outlined above, but further he should not go—not as an auditor reporting on financial statements reflecting the financial transactions up to date. However, as an investigator making a report to prospective investors an accountant most certainly should draw attention to such a situation.

The Public Viewpoint

One matter which has perhaps not had the attention it deserves is that of education of the business community to the limitations of balance sheets and auditors' reports thereon. The writer has often felt that the balance sheet and auditors' report are too often drawn up as if they were to be read only by other accountants conversant with the technique of accounting and auditing. Furthermore the traditional form of balance sheet is often most confusing to a layman. This traditional form is a relic of the trial balance and should have been discarded long ago. On being asked by a layman how a deficit could be described as an asset of the company the writer could offer no justifiable reason except that it has to appear somewhere and it adds up right if put on the assets side being a bookkeeping debit! A deficit, it will be agreed, is not an asset and it is known as an asset only by reason of the adherence to a "trial balance" mentality in presenting a balance sheet. It is true that a growing number of firms, especially in the United States, are discarding the traditional form of balance sheet in favour of a more intelligible form of statement, but the writer feels that it is time that the accounting profession should take a more positive lead in this matter.

Example of Modern Form

The modern form of financial statement being adopted by some companies, especially in the United States, is perhaps not a balance sheet in the strict sense because it fails to show all assets on one side and all liabilities on the other. An example of this form is shown below:—

SHAREHOLDERS' ACCOUNTS

Capital Stock			
Authorized—10,000 shares of $100 each		$1,000,000	
Issued & fully paid—5,600 shares			$560,000
Surplus			
Capital Surplus			
Balance at 1st January 1942		$ 45,000	
Add: Net gain on disposal of capital assets during year to 31st December 1942		5,000	
		$ 50,000	
Earned Surplus			
Balance at 1st January 1942	$55,000		
Add: Profit for the year ended 31st December 1942	25,000		
	$80,000		
Less: Dividends paid in 1942 ..	20,000	60,000	110,000
			$670,000

represented by net assets as follows:—

Current Assets			
Cash in Banks and on Hand			$ 60,000
Trade Debtors and other Accounts Receivable			120,000
Inventories (at the lower of cost or market value)			85,000
			$265,000
Deferred Charges			5,000
Fixed Assets			
Land and Buildings at cost		$ 60,000	
Machinery and Plant at cost		850,000	
		$910,000	
Less: Reserve for Depreciation		205,000	705,000
			$975,000
Deduct:			
Current Liabilities			
Trade Creditors and other Accounts Payable		50,000	
Amount due to or reserved for payment to Taxing authorities		15,000	
Accrued Charges		2,000	
		$ 67,000	
Debentures			
5% Floating Charge Debentures due 1st January 1956		$238,000	$305,000
NET ASSETS			$670,000

Accounts issued to shareholders should be issued in as intelligible a form as possible—intelligible, that is, to the layman. Every Canadian accountant knows what is meant by the term "distributable surplus" but how confusing this could be not only to laymen but to accountants in other countries! Admittedly this is a term laid down in the Companies' Act and its alteration can only be secured by amendment to the Act.

There has been a considerable amount of criticism of auditors in London recently led by the publication *The Economist*. Much of it was unjustified, but might never have been levelled at the profession if the business world were better enlightened in the functions of the auditor and in his limitations.

The writer suggests that the profession might well consider undertaking some publicity aimed at clarifying in the minds of the business public the limited functions of the shareholder audit. At the same time the profession should always be on guard against the use of language and terminology which, while clear to other trained accountants, may be confusing to laymen. Where reports contain qualifications, these should if possible be so worded that the shareholders can understand what is meant, irrespective of whether or not they are trained accountants.

A TRUE STORY

One of our Toronto members had on numerous occasions advised a client to have his accountant bonded without result. Finally as a possible alternative he wrote a letter to the client re-affirming the importance of such protection and suggesting that possibly he might take out a Blanket Fidelity Bond as explained in a brochure of a large insurance company which he enclosed. The client, president and manager of his own substantial-sized company, replied as follows:

"Thanks for your letter of 1st March which I took home over the weekend to study carefully.

"I return the enclosures herewith, but I am afraid that I have not decided to change my life-long objections to questioning the integrity of the people amongst whom I spend the greater part of my waking hours. In other words, I prefer to be robbed, if necessary."

POST-WAR PROVINCIAL CORPORATION TAXES

By Frank S. Capon, Chartered Accountant,
Montreal, P.Q.

EACH day that passes is a day nearer the end of the war —in other words, a day nearer the time when post-war plans must be put into effect. Time has a habit of passing unnoticed, and we have all too short a period in which to draw up a blueprint of the post-war world. Experience has taught us that unless carefully drawn up plans are completely ready at the moment they are required, we are liable to be forced to adopt ill-considered substitutes or to suffer interminable delays while minor issues are being debated. Any post-war planning that can be undertaken now without harming the nation's war effort should therefore be looked upon as a move towards winning the peace. It is with this thought in mind that the following remarks on provincial corporation taxes are submitted for consideration at this time.

Legislation already on the Dominion and Provincial statute books provides that pre-war provincial corporation tax acts and procedures shall be reinstated after a short readjustment period following the war. All accountants are aware of the very substantial savings in both time and money that have resulted from the suspension of the provincial acts, through the decrease in the number of returns that must be prepared by industry and examined by government officials and the savings in time previously spent in studying annual changes in all of the various tax acts. These savings can be continued after the war, without excluding the provinces from the income tax field, but unless necessary arrangements can be completed in time to forestall the automatic re-instatement of the provincial acts, we shall once again be lost in the political arguments that seem to be inseparable from such proposals.

It is becoming more evident daily that direct taxation will play a major role in the post-war world, not only as a source of government revenue but, more important, as a means of guiding and controlling trends in production, employment, capital expenditures and other phases of national life. To achieve these ends, direct taxation will have to be centralized with the Dominion government, which may well have to use such weapons in accordance with co-

ordinated international plans, but this may not prevent the provinces from levying taxes on income to meet those local expenditures which will still fall within their jurisdictions.

A sound tax program should be the fruit of the co-operative efforts of three highly trained specialists—the economist, the lawyer and the accountant. When government revenue requirements are known, it should be the task of the economist to make recommendations as to the proportion that should be obtained from each of the various sources—direct taxes such as income taxes and succession duties, and indirect taxes such as sales taxes, customs duties and excise duties. The economist's recommendations must be based on overall planning with a view to correcting faults in economic conditions then existing. With the approved proposals in hand, the lawyer takes over and drafts the bill, in close consultation with the economist and the accountant who must both see that their respective points are covered adequately. Finally, after the elected representatives of the people have enacted the proposed legislation, the accountant must set up the mechanism for collecting the revenue, leaning upon the lawyer from time to time for interpretations when he is unable to reach agreement with the taxpayer. It will be seen, therefore, that the professional accountant has a responsibility to the public to offer his trained assistance in the planning of tax collection procedures, particularly when it is possible to effect substantial savings for both the government and the taxpayers without affecting materially the disposition of the tax revenue.

History of Canadian Income Taxation

The British North America Act gives the Dominion power to levy taxes by all or any means, but gives to the provinces the authority to levy only direct taxes. It was hoped that provincial functions would be discharged with economy, and that the interest of the people would be sufficiently strong to keep such direct taxation to a minimum. Because the provinces were limited to the direct tax fields, the Dominion made every effort to tap only indirect sources of revenue, and when Sir Thomas White introduced the first Dominion *Income War Tax Act* in his budget of 1917, he stated: " . . . since the outbreak of war, I have hesitated to bring down a measure of federal income taxation. As

I have stated, the provinces and the municipalities are confined to direct taxation, and I have not regarded it as expedient, except in cases of manifest public necessity, such as I believe exists at the present time, that the Dominion should invade the field to which the provinces are solely confined for the raising of their revenue."

The Province of British Columbia had introduced an income tax measure in 1876, but the remaining provinces entered this field only in the late 1920's or early 1930's, and the Dominion income tax stayed on after 1918 as an important source of revenue not being used extensively by the provinces. By the time provincial and municipal budgets had reached levels that forced those governments to enter this lucrative revenue field, the tax was a major source of Dominion revenue, and had been for a number of years. The provincial taxes were therefore generally pyramided on top of Dominion taxes (since only two provinces allow the Dominion tax as a deduction from taxable income) and the rates increased steadily.

At the Dominion-Provincial conference held in 1935, the provinces were almost unanimous in their suggestion that the Dominion should withdraw from the field of income taxes in order to stop competing with the provinces in the direct tax field to which the provinces are restricted. The Dominion government was manifestly unable to accede to this suggestion, but it did not put forward a plan for the collection of all income taxes by the Dominion Income Tax Division, in order to reduce collection costs to the provinces. This important constructive step, which included the filing of standard tax forms for the Dominion and provinces, was unfortunately adopted by only two provinces in so far as corporation taxes were concerned.

The problem of Dominion-Provincial conflict in the tax field was again brought to the fore by the Rowell-Sirois Commission Report, which states in part: "The joint occupation by the Dominion and the provinces of the progressive tax field (except inheritance taxes) and the corporation tax field led in the one case to inadequate use and in the other to wasteful duplication. As a consequence far too great a proportion of the load of government expenditure was carried by regressive consumption taxes, by real estate taxes and by economically harmful taxes on corporations and business."

Once again a Dominion-Provincial conference was called for January 1941 for the purpose of implementing plan 1 of the Rowell-Sirois Report and following statements that the Dominion would need to take over the income tax field exclusively under pressure of wartime requirements. The conference ended abruptly without coming to any agreement, in spite of well-reasoned speeches by several provincial premiers arguing that the income tax field should, for practical reasons, be reserved for the Dominion. Other provinces disagreed violently with this proposal, although it is noteworthy that these latter adopted largely political arguments as opposed to the logical reasoning of the former. Nevertheless, agreement was not reached, and if it was impossible for Dominion and provincial representatives to come to an agreement in a time of national crisis, how much less hope is there for reaching a satisfactory settlement in time of peace when today's pressure no longer applies!

Suspension of Provincial Tax Acts

In his budget speech released shortly after the abortive 1941 conference, the Minister of Finance announced that as a war measure the Dominion government found it necessary to make very substantial increases in rates of taxes applicable to the rapidly rising corporate and individual incomes, and to offer to the provinces fixed sums based on their 1940 personal and corporation tax revenues, in return for the suspension of provincial tax acts for the duration. He pointed out that other provincial revenues would be increased substantially as a result of the immense war expenditures to be made by the Dominion government, and that the provinces would not also require the sharply higher tax revenues that would automatically accrue on the higher incomes. On the other hand, the Dominion government had a very pressing need for such extra revenue, not only from the revenue viewpoint, but also because the need for siphoning off income in excess of available supplies was becoming increasingly apparent.

Following prolonged discussions, agreements were signed with each of the provinces early in 1942. These agreements were almost identical in form, and included among others the following provisions:

1. The preamble states that it is expedient *during the continuation of the war and for a certain re-adjustment period*

for the Dominion only to levy taxes on income and on corporations.

2. The provinces agree to suspend their personal income and corporation tax legislation.

3. The Dominion undertakes to pay annually to the provinces either: (a) An amount equivalent to the total of revenue obtained by the provinces and municipalities from such taxes in the fiscal years ending nearest to 31st December 1940; or (b) an amount equivalent to the net debt service of the provinces for the same period, less revenues obtained from succession duties.

4. The Dominion has the sole right to levy taxes on personal and corporate incomes earned from 1st January 1940 to end of calendar year ending on 31st December nearest to the date of termination of the agreement.

5. The Dominion specifically undertakes to reduce tax rates in the following year in order to allow provinces to get back into the income tax field.

6. The agreements may be cancelled before the end of the war, but terminate automatically on the last day of the fiscal year of each province ending nearest to 31st December of the first year commencing after the termination of the war. It will be seen from the above that considerable emphasis is placed on the fact that the provincial acts are only suspended, particularly by the fact that the Dominion specifically undertakes to reduce its tax rates in order to facilitate the resumption of provincial taxation. The initial agreement of some provinces could probably not have been obtained unless this had been so emphasized, and both Dominion and provincial ministers reiterated this point at the time the agreements were actually executed. Nevertheless, very important savings, undoubtedly running into many millions of dollars, have been realized in tax collection expenses of government, and in the costs incurred by industry in interpreting and attempting to comply with the multiple taxation, and such savings should be sufficient incentive to justify real efforts to demonstrate clearly to the provincial governments that these savings can be continued without affecting provincial revenues or autonomy.

Administrative Difficulties of Multiple Taxation

Under the pre-war Canadian corporation taxation system, all companies were obliged to conform to the Dominion *Income War Tax Act*, the corporation tax act of each province in which they did business, and the income tax legislation enacted by certain municipalities. Thus, a Dominion company doing business in every province would require to conform to ten acts, excluding municipal legislation. If the amounts of tax involved are anything but negligible, it is necessary for relatively highly paid officials to devote a considerable amount of time to studying and interpreting the legislation, and to devote further time to the preparation of the necessary returns.

All provinces attempt to tax profits earned within their boundaries, but in the case of companies doing business in more than one province this is by no means an easy figure to calculate with accuracy. The bases of calculating taxable income were by no means uniform since expenditures allowed as deductions from taxable income differed from one province to another, while in some cases the basis for taxation of resident companies varied from the treatment of non-resident companies. In at least one province, the tax act provided for levying taxes on profits earned on sales to residents of the province by companies not doing business in the province.

A major difficulty encountered by companies was the completion of multiple returns. The splitting of taxable income between provinces required a great number of arbitrary calculations, while the computation of the proportion of capital employed in each province for capital tax purposes also presented difficulties. When all these calculations had been made, and the multitudinous questions had been answered, it was necessary to draw a cheque payable to each of the various governments, constituting further waste of work in industry and banks.

From this point, the worries were taken over by the provincial governments, which had to set up staffs to receive the returns and cash, and also to administer the acts and to make assessments. Practically all of this work was duplicated in each of the provinces and the Dominion; furthermore the provincial assessing staff could seldom make

an adequate examination of returns filed by companies not resident within the province.

Possible Single Taxation Structure

The above are only a few of the major difficulties encountered by industry under the multiple tax system. It is not necessary at this time to go into further details, since all qualified accountants are thoroughly familiar with these problems. However, it is felt that the multiple tax system can be eliminated without taking from the provinces the right to levy income taxes at rates varying according to their individual requirements from time to time.

In the first place, the various provincial and municipal corporation tax acts would be repealed and each province would adopt the Dominion *Income War Tax Act*, providing at the same time for automatic adoption of any amendments put into effect by the Dominion. An added section to each act would provide that one return only had to be filed by each taxpayer with the Dominion government, covering the total income taxable in Canada and including an analysis of sales by provinces to enable the taxable income to be allocated between the various provinces. Tax would be calculated on the total income at the Dominion rate, and on the income allocated to each of the various provinces at the rates established by each. The Dominion authorities would thus have full authority to administer the act, to examine and assess returns, and to collect the total taxes owing by the taxpayer. They would in turn pay over to each province its share of the total revenue as computed in the tax returns.

The first criticism of such a plan would be of a political nature—that the provincial governments would be sacrificing their autonomy since they would not be in a position to control legislation under which direct provincial tax levies would be imposed. It must be emphasized, however, that no tax is levied merely for the sake of collecting taxes —it is levied in order to obtain revenue. The computation of taxable income does not differ materially under the various provincial or Dominion acts, and the amount of revenue that would be obtained at a given tax rate under either would be substantially the same. Therefore, the fact that the provincial governments would not be in a position to make individual changes affecting the computation of

taxable income from year to year would not have any real bearing on the amount of revenue obtained by the provinces.

Tax rates are the governing factor in determining the amount of revenue to be obtained, and each province could retain full authority to establish the rates that would be applied to the proportion of taxable income allocated to it. By this means, the provinces would have actual control over the total revenue to be obtained, and the objection to the lack of control over administration is therefore purely political.

Considerable emphasis was placed on the undesirability of varying tax rates by the Rowell-Sirois Commission, and many, if not the vast majority, of qualified accountants agree emphatically with this section of the Commission's report. There is, nevertheless, a considerable amount of weight to the argument that the people of any locality should be free to decide the means by which they should contribute the revenue required to meet the local government's requirements, and if the people of one province choose to pay their taxes on income rather than automobile licences or liquor, they should not be subject to criticism by other provinces that have different tax policies. It is not proposed to add any fuel to this political fire at the moment, however, and the above proposals are based on the premise that the provinces will not be prepared to stay permanently out of the income tax field.

It is almost inevitable that the Dominion will be able to maintain a more efficient tax administration organization than the provinces could support. The provinces may obtain the services of a few unusually capable men in this field, but taking the complete organization into account, it is safe to assume that the much larger Dominion organization will do a better job. Under these circumstances, the provinces stand to gain by adopting the better planned Dominion act, and by allowing the more efficient Dominion organization to examine tax returns and collect provincial revenues. In order to give the provincial governments some voice in amendments to the single act, it might be possible to establish a committee of provincial treasurers which would submit a brief to the Dominion minister covering suggested revisions of the tax structure, including rate changes, prior to the preparation of the Dominion budget.

Substantial savings would be realized by taxpayers under the above single-taxation scheme, while the overall government administration and collection costs would also be lower. The cost of operating the single government organization would, however, necessarily be higher than the amount required by the Dominion alone under the pre-war multiple tax structure, and a part of the cost of the unified organization should therefore be passed on to the provinces. This is a minor matter that could be worked out between the various governments following adoption of the main principles of the proposal, and at this time it is suggested that the total cost of the administrative organization should be prorated over the various governments in the proportion of the revenue obtained by each.

Conclusion

When considering post-war tax plans, it must always be borne in mind that taxes on individual and corporate incomes may play so great a part in the post-war national or international economic structure that it may be necessary for them to be reserved exclusively for the central government. On the other hand, provincial governments will probably be retained to take care of local needs, and since the revenue required for these purposes will be small, it may well be raised by way of income tax without disturbing the main taxation structure. The chief advantage of provincial corporate or individual taxation is the high cost of collection, and it is in the nation's interests that such government costs be kept to a minimum.

The accounting profession is in an excellent position to draw up a suitable program for post-war provincial corporation taxation, and to submit a program to the various governments. The provincial institutes or societies could discuss such a plan with their respective provincial governments after a unified program had been drawn up by the Dominion Association, which would at the same time discuss the plans with the Dominion authorities. This subject is one in which professional accountants have a vital interest, and their views have always been respected and valued by the various government bodies.

PROBLEMS IN PRICE CONTROL

By C. H. Mitchell, Chartered Accountant, Montreal

(This is a revised copy of a lecture given in February, 1943, at Sir George Williams College, Montreal, to a study group on taxation and government controls by Mr. Mitchell, who is supervisor of the prices division of the Wartime Prices and Trade Board.)

THIS subject has been so much before the public for the past year or more that there seems little that can be added to what has already been written or said. However, as this group is primarily interested in a study of taxation and government control I think you may be interested in the more technical aspect of this subject rather than listening to a lecture on the evils of inflation and the circumstances leading to the adoption of price control. Therefore, it is my intention to commence this paper with the adoption of price control in Canada.

Adoption of the Price Ceiling

With the prime minister's radio and press announcement about the middle of October, 1941, Canada started on an unblazed trail, a trail over which no free people of their own accord had ever trod. However, the adoption of price control was only one of a number of actions taken by our government to prevent inflation and to facilitate the fullest and most efficient use of our manpower and materials toward fighting the war. The great discrepancy between rising spendable incomes and diminishing civilian supplies has called for the use of a variety of controls over consumer incomes and demands and I will summarize the five main approaches:

1. **Wage and Salary Ceiling:** Price control could hardly be expected to succeed if industries were allowed to bid against each other for the ever declining manpower, so the government froze wages at levels existing at the time of the prime minister's announcement. Certain exemptions were allowed, such as increases for, (a) additional responsibilities, (b) promotions, and (c) normal increases within certain limits.

2. **Profit and Income Controls:** I need merely mention these controls. All of us know how effective the new income taxes have been in draining off *our* surplus incomes, if any, and also how effective the excess profits tax act has been

insofar as industrial profits are concerned. Then, in case any of us still had a few pennies left, a Victory Loan is being launched about every six months. The minister of finance, not being absolutely certain he had covered everyone, added a compulsory savings feature in the last budget, so now I believe everyone has been caught either coming or going, or both.

3. **Allocation and Rationing Controls:** In order to ensure our armed forces an adequate supply of munitions, etc., it has been necessary for the government, almost from the commencement of the war, to allocate and ration certain critical materials. Such materials as steel, rubber, tin, coal, wool, etc., have been carefully watched and allocated or rationed for industrial use. Similar steps were taken in order to maintain an equitable allotment of goods in short supply for use by civilian consumers.

4. **Manpower Controls:** As the demands on Canada's manpower became more and more severe and as shortages developed in those industries essential to the war effort, steps were taken to ensure an adequate supply of workers. Thus, the National Selective Service Board was established and workers were required to obtain permits to move from one job to another. All workers now are required to obtain a release, signed by the National Selective Service Board, before they can apply for a position and that Board has the authority to direct workers into channels where their efforts will do the most good in furthering our war effort.

5. **The Overall Price Ceiling:** The government's overall price ceiling policy froze prices at the highest level at which goods were legally sold during the period September 15 to October 11, 1941; this period immediately became known as the basic period. Each establishment has its own ceiling prices—retailers, wholesalers, manufacturers, etc. —and herein lay most of the board's early problems in administering the government's price control policy.

Three Main Problems

However, other problems soon developed and for the purposes of this paper I propose to deal with them briefly under three headings; first—supply, secondly—distribution, and thirdly—pricing.

Supply: It was not long before maintaining adequate supplies became one of the major problems confronting the

board. Hardly had the price ceiling policy become effective before Japan made her dastardly attack on Pearl Harbour, followed by Hong Kong, Singapore, Burma, etc., etc. Our supply of tin, jute, many of our vegetable oils and other essentials were cut off, in addition to which our supply of tea, coffee and raisins was seriously menaced. In order to ensure tin, as an example, for use in the manufacture of war materials, it became necessary to drastically reduce the domestic consumption of this commodity; thus we find many products now being packed in glass, fibre and paper containers which were formerly put up in tin.

Distribution: As consumer demand increased and scarcities developed, some action was required to ensure an equitable distribution of available goods among manufacturers, wholesalers and retailers. Therefore the board, in an amplification of the original statement of policy, stated: "In a large number of lines of merchandise, manufacturers and wholesalers (herein referred to as suppliers) can no longer supply the full requirements of retailers. Where this condition exists the supplier must allocate his available supply ratably among his customers to whom he sold merchandise in the year 1941. Thus, if a supplier in the year 1942 had available only 60 percent of the goods which he distributed in 1941, each of his customers would be entitled to a quota of 60 percent of the purchases made by that customer in 1941." This action was taken by the board primarily as protection for the smaller operator who had neither the capital nor the storage facilities to purchase in advance but who is vital as a distributing agent.

Although rationing or allocating of goods has been quite common among industries and trades, up to the present it has been necessary to resort to consumer rationing only in the case of sugar, tea, coffee, butter and meat.

The Problem of Pricing

Pricing: I have left pricing problems to the last because these are the problems with which I am most familiar and also which I think most vitally affect each individual. These problems can be dealt with under four main headings: (1) Price anomalies; (2) New goods; (3) Substitutes; (4) The time lag.

Price Anomalies—In the early days of the board's operations, one of its main endeavours was to maintain a proper

distribution of goods to consumers. In order to accomplish this, many inequities had to be ironed out. For example, a retailer in a community may have established a ceiling price for a specific line which was abnormally low compared with prices charged for the same merchandise by other retailers in the same district. These low prices were usually the result of purchases having been made some considerable time prior to the basic period and the replacement cost, in many cases, may have exceeded the established ceiling price. Obviously, it would be unfair to expect the retailer to maintain his ceiling prices on such lines. Therefore the board, in order to maintain the supply of goods to the consumer, permitted such retailer to increase his prices to the level of prices charged by other retailers after having been provided with ample proof in respect to the general level of prices in that community. At this time the board is of the opinion the cycle has been completed and that no further anomalous price situations will be considered, except in cases of extreme hardship.

New Goods—Under this heading I will treat, in addition to new goods, merchandise of a seasonal nature not normally sold by retailers during the basic period (Sept. 15—Oct. 11, 1941).

When a manufacturer produces a new line of consumer goods that is dissimilar to lines formerly produced, it is required that a sample of the merchandise be submitted to the appropriate administrator together with cost sheets showing the break-down of the cost items in some considerable detail and the proposed selling price. The sample is examined by the administrator or technical expert to determine the quality of the product as compared with the most nearly comparable article formerly produced. Costs are scrutinized also with particular attention being paid to such items as selling and administrative expenses and profit margins. The administrator, having satisfied himself as to the comparable quality of the product, the reasonableness of the cost figures and profit margins, submits the application to the board for approval of the manufacturers' selling prices. Any fixation of prices of goods that are dissimilar is at the importers' or manufacturers' level, with fixed maximum markups for sale at wholesale and at retail.

In the case of seasonal merchandise such as summer and

winter sports goods, the manufacturers' price during the current season was usually based on the selling prices established during the preceding season with, in some cases, a very moderate increase allowed to take care of additional costs during the intervening period up to the basic period; the wholesalers and retailers being allowed to add their normal markups to the increased prices. As a complete year has gone by, this problem is now one that belongs to the past and the prices set for 1942 seasons will be the basic prices for subsequent seasons.

Substitutes—As I have stated previously many materials are needed for war purposes to such an extent that the government was forced to drastically curtail their uses for civilian purposes. Typical of such curtailment is the action taken in respect to steel, tin and manila hemp where the use of these materials was prohibited in the manufacture of certain civilian goods. As a result, it became necessary to produce substitute products to take the place of commodities such as coiled spring mattresses and manila rope for civilian use. Consequently, selling prices have to be established for such substitutes. This is accomplished by an examination of the new product and a comparison of the estimated costs with the actual costs of the most nearly comparable article formerly produced. At the same time, the quality of the new product is compared with the one it is replacing.

Another problem that may be considered under this heading is in respect to products formerly packed in tin and now being packed in other containers such as glass or paper. It is the policy of the board that where costs have increased due to the change from tin to other containers, the increased costs must not be passed on to the consumer. This seems a relatively simple problem and it would appear that the solution lies in obtaining the cost per pound of product packed in each size of container and apply the same cost per pound to the new container. Unfortunately, the solution is not so easy as that. In many cases, in order to meet the increased demand for glass and paper containers, standard sizes have been decided upon with the result that very often packers who had put up their products in a variety of sizes are now able to use only one size. It is, therefore, required that a price be established that will,

on the average, assure the same net price per pound of product to the consumer. This, of course, means that those consumers who formerly purchased large sized containers may pay slightly more per pound for the product, while those who purchased in smaller sizes will reap the benefit thereof. However, on the whole, prices to the consumer will not be allowed to increase due to the use of different containers.

The Time Lag—I have now come to the more complex problem of the time lag between the period when the raw materials which went into the finished product were purchased and the period during which the product was sold at retail. For our purpose this is the basic period, Sept. 15—Oct. 11, 1941. This time lag may extend anywhere from six to eighteen months and its solution involves "squeeze adjustments" and, in some cases subsidy payments, with both of which we are familiar.

In order to present a concise statement of this problem I will endeavour to outline the procedure followed in a typical case which has been handled by the board. In this case we will sectionalize the industry as between retailers, secondary manufacturers and primary manufacturers. Let us assume the secondary manufacturers have approached their administrator stating retailers cannot pay the established selling prices of the manufacturers during the basic period and maintain the retail price ceiling. The following information is presented:

1. Retailers' selling prices during the basic period were based on the secondary manufacturers' prices during the spring of 1941.

2. The secondary manufacturers' prices in the spring of 1941 were established on costs based on quoted selling prices by the primary manufacturers in the fall of 1940.

3. The primary manufacturers' selling prices in the fall of 1940 were based on raw material prices prevailing during the spring of 1940.

4. Costs of the secondary manufacturers had increased approximately 10% between the spring of 1941 and the basic period.

The administrator then requests the prices division—accounting section, to make a survey of the situation in order to establish the facts.

After a clear understanding of the problem has been reached with the administrator, the whole question is discussed with the industry advisory committee. At the completion of these discussions a draft questionnaire is prepared and reviewed with accountants from the industry representing small, medium and large organizations. These accountants are asked to criticize the proposed form, offer suggestions and, in general, satisfy themselves that the information can be provided readily. Also, they are requested to question the necessity of any information asked for so that industry will not be asked to supply data that is not absolutely essential to the solution of the problem. When the questionnaire has received the approval of the accountants in the industry, the administrator and the advisory committee, it is issued to the industry after being cleared through a co-ordinating committee in Ottawa to make sure that the data requested is not available through other sources.

The information usually requested covers, (a) operating results and financial position for a three to five year period, (b) material costs at stated periods, (c) labour rates and hours worked during a definite period and (d) other relevant information in respect to sales distribution, unit costs and selling prices. In the assumed case, the data which the secondary manufacturers would be required to furnish would be along these lines:

1. Financial statements for the fiscal years ending in 1939, 1940 and 1941.

2. Raw materials consumed in production during 1941—each material to be listed separately, together with the quantity used.

3. Raw material prices in effect during the fall of 1940 and replacement costs during the basic period.

4. Hours worked per operator for each operation during, say, March 1941 and the number of operators employed on each, together with wage rates in effect during March and October 1941.

5. An analysis of sales between wholesalers, department and chain stores and independent retail stores and according to districts, usually provinces.

From this information it is possible to obtain, (a) an overall picture of conditions existing in the industry, as

well as trends over the three year period, (b) a weighted average raw material cost increase between the fall of 1940 and the basic period, (c) a weighted labour cost increase between March and October 1941, and (d) the method of sales distribution and the territories in which sales are made.

A reasonable time is allowed for the industry to reply to the questionnaire and during this interval the senior accountant responsible for the survey usually visits a representative group of establishments in order to become acquainted with conditions existing in the actual operation of the industry. At the same time, advantage is taken of the opportunity to discuss, with senior officials of the firms visited, possible action that might be taken to assist in effecting economies and reducing costs.

The replies to the questionnaire are tabulated and a report prepared for the administrator, showing the overall results of the industry with a further break-down of operations between volume and profit groups. These groupings are presented in order to show the effect on certain operators of any decision based on the overall picture. For example, the overall picture may be heavily weighted favourably by a few larger operators or very profitable establishments and a decision based thereon might seriously affect a considerable number of smaller or less profitable operators. This fact is always uppermost in the mind of the administrator and the board so that action that would jeopardize the position of the smaller firms or adversely affect the usual channels of production and distribution may be avoided.

In addition, it is developed in the report, (a) the ability of the industry to absorb all or a part of the increased costs, (b) possible courses of action that could be taken to effect economies, and (c) the amount of assistance it is considered necessary that the government should provide in order to maintain the retail price ceiling.

Individual reports are prepared for each section of the industry and trade with a consolidated summary showing, (a) the total cost increase, (b) the amount of squeeze to be absorbed by each section, and (c) the total assistance in the way of subsidy required to prevent an increase in retail prices. The report is submitted to the administrator for

his consideration and guidance and, after careful study and discussion of the contents with his advisory committee, the administrator makes his recommendation to the chairman of the board.

One point I would like to emphasize at this time is that the operations of individual companies are treated as strictly confidential by the accounting section and the report to the administrator is compiled in such a way as to maintain the confidential nature of a firm's operations.

Adjustments and Subsidies

I do not think it would be proper to conclude a paper of this kind without a brief reference to "squeeze adjustments" and "domestic subsidies."

Squeeze Adjustments: The "squeeze" is a most apt word and is used in connection with the absorption of increased costs by the various sections of an industry and trade. Before subsidies are paid, the applicant, whether it be an individual firm or an industry, is required to absorb as great a portion of the increase as it can without seriously affecting its operations.

Many arguments are used for and against the requirement that a good part of the increased cost be borne by industry and I believe most people support the board in its stand in this respect. However, there is a small minority who argue that industry should not be required to absorb increased costs and that the excess profits tax will take care of any excessive profits that may be made due to subsidy payments. This argument can be refuted easily. In the first place, it is the board's responsibility to maintain the price ceiling at the lowest possible cost to the taxpayers and the excess profits tax does not assure a complete refund of all excess subsidy payments over the minimum requirements of an industry. Secondly, it does not provide an incentive to industry to effect economies. In other words, once an establishment enters the excess profits tax bracket there is not the same incentive to reduce expenses and operate more efficiently. Therefore, by requiring industry to absorb as great a portion of the increased costs as possible, profits are reduced and businessmen automatically commence to look for ways and means of reducing costs. I am sure you will agree that this is the only sensible approach to this problem.

Domestic Subsidies: Just a word in respect to domestic subsidies. These subsidies are paid in a general way for two reasons: First, to reduce prices to the consumer and second, to stimulate or maintain production, at the same time enabling consumers to obtain merchandise at established basic period prices.

In respect to subsidies paid to reduce prices, the action of the board in reducing the price of tea, coffee, milk, etc., is a typical example and resulted in a direct saving to the consumer. Insofar as subsidies to stimulate or maintain production and in order to maintain the price ceiling are concerned, you will realize that they are paid only after the industry and trade has absorbed as great a portion of the increased cost as it can without seriously affecting its operations. An industry is sometimes criticized because it is the recipient of government assistance. Such criticisms are unfair to the industry concerned. Domestic subsidies are not paid to an industry in order that it may exist but are paid theoretically to the consumer so that they, the consumers, may obtain the necessary goods at prices prevailing during the basic period and so that the cost of living will not rise. If possible, the ideal situation would be to subsidize the consumer but, as you will recognize, administratively this is impossible, therefore the board pays a subsidy usually at a point which will involve the fewest number of firms.

I might point out also that subsidizing to hold down prices is much more equitable than subsidizing consumers by means of cost of living bonus because in the latter case only a certain number of people benefit. Farmers, professional and businessmen, those with incomes from investment and many others, do not enjoy the cost of living bonus.

I realize this has been a very sketchy picture I have given you tonight but I trust the question period will fill in many of the details and bring into bolder relief some of the main features of the board's activities. I wish to thank you for the opportunity of addressing you this evening and I trust I have left with you something that will be of interest and, at the same time, prove beneficial in the conduct of your daily business.

DEPRECIATION POLICIES OF CANADIAN PUBLIC CORPORATIONS

By Professor C. B. Wade, Chartered Accountant, Kingston, Ontario

THE purpose of this study is to ascertain to what extent and under what circumstances, if any, Canadian corporations vary their depreciation charges from year to year in accordance with income.

For convenience in this discussion the term "straight line method" of depreciation refers to the consistent use of the same rate of depreciation irrespective of fluctuation in production, net income or the extent of use of the asset. Such a method of course accurately measures depreciation incurred only if the assets depreciate by virtue either of weathering, which continues irrespective of use (e.g., telephone poles) or of the development of inventions, i.e., obsolescence[1]. Clearly if the asset will be abandoned because its maintenance costs are too high relative to a new (but unimproved) asset, i.e., if the asset depreciates solely because of use, then the straight line method of depreciation does not record the facts where production fluctuates. For here the cost and quantity of the aggregate fixed asset services used in an income period can be definitely correlated with use. Where weathering or obsolescence is the determinant the quantity of units of service that have been *utilized in production* will not necessarily be equal to the quantity of units of service that have *expired*, i.e., been used in production *and* lost by virtue of the shortening of possible service life through obsolescence. It is quite true that invention in the industrial arts does not by any means always proceed at an even pace. For some years there may be few improvements in certain assets. Then suddenly great strides forward will be made and masses of machinery will become obsolete. But it is unnecessary to prove the futility of attempting to reflect such movements in fluctuating depreciation charges. It is denied by no one that obsolescence can only be assumed (for purposes of booking its effects on the accounts) to be an even continu-

[1]Fixed assets also become obsolete by virtue of the cessation of demand for the output of the asset. However, it is doubtful whether depreciation is supposed to record such obsolescence.

ous process thus requiring even continuous depreciation charges.

Whether or not it is ever possible to know in advance whether an asset will depreciate by wear and tear or by obsolescence, the writer does not know. Nor does he know what proportion of assets is subject to the one or to the other. Fortunately this ignorance is immaterial as one is concerned here not with whether or not the straight line method of depreciation should or should not be used, but with whether it is used. As the data that follow show, it is not under certain circumstances used by a very significant number of companies.

Depreciation When Earnings are Sufficient

Because of the rules formulated by the Minister of National Revenue in exercising his discretion concerning depreciation allowances in determining taxable income one would expect that so long as earnings *before* depreciation are sufficient to cover full depreciation, the straight line method of depreciation will be used, that is to say rates no lower than those permitted for tax purposes will be applied irrespective of fluctuations in output or earnings. And this broadly speaking is the case.

The income statements of 199 Canadian public corporations were examined for the years 1934-1940 inclusive and it was discovered that with a few minor exceptions no corporation reduced its depreciation charges in any substantial amount *so long as its earnings before* depreciation were sufficient to absorb the usual amounts of depreciation—this in spite of wide fluctuations in net income. As already suggested these results were to be expected and of course do not prove that the straight line method is used when taxation does not require it.

Depreciation When Earnings are Insufficient

The test of whether or not management have decided upon the straight line method arises when earnings *before* depreciation are insufficient to absorb the depreciation charges demanded by this method. If full depreciation is not then charged this comprises *prima facie* evidence that the straight line method will necessarily be used only when tax laws make it desirable.

In applying this test the years 1937 and 1938 were

chosen for analysis. The year 1938 was one of recession; production and profits dropped substantially[1]. Since 1933 only this year (1938) is available for the test for this is the only year between 1933 and 1940 in which production and profits declined at all substantially for any number of corporations[2]. Even this year does not yield a really satisfactory sample, for of 199 corporations only 43 recorded either losses *before* depreciation, or earnings *before* depreciation that were insufficient to absorb the same depreciation charges that had been made in 1937[3]. We must perforce be content with the data derivable for this small sample and at the same time use caution in accepting the results.

Of the 43 corporations 18 incurred cash losses, i.e., losses *before* depreciation. Their depreciation policy is shown on the following table:

TABLE I

Depreciation Policy of 18 Companies Which Incurred Losses Before Depreciation, in 1938

No. of Co.'s		*Profits, Before Depreciation*	*Losses, Before Depreciation*	*Depreciation*	
		1937	*1938*	*1937*	*1938*
	Depreciation Policy	'000	'000	'000	'000
7	Charged no depreciation	2,137	1,159 L	1,787	Nil
2	Charged ½ or less of 1937 charges	143	97 L	86	42
9	Charged 100% of 1937 charges	472	709 L	735	763

This table reveals that faced with no earnings available for depreciation 7 companies out of 18, i.e., 39%, charged no depreciation. Bearing in mind the size of the sample it is reasonable to conclude that under these circumstances a very significant number of companies will abandon the straight line method of depreciation rather than add to

[1]The Bank of Canada records a decline from $386 millions to $320 millions in profits (before income taxes) during 1938 for 484 corporations.

[2]The study cannot go further back because only with the introduction of the present Companies Act in 1934 did published financial statements reveal enough information for a study of this kind.

[3]The depreciation charges of each company for the years 1934 to 1940 both inclusive were scrutinized. The figures that follow include only cases where the 1938 depreciation charges were less than 1937 (and where 1937 was itself representative of previous years) *and when the charges were restored in 1939.* In other words all permanent reductions in depreciation have been excluded.

losses. At the same time the wide extent to which the straight line method is used in Canada is suggested by the fact that 50% of the 18 companies booked full depreciation and thus (in the aggregate) added depreciation equal to their cash losses.

The other aspect of the test which we are making is this: how many companies faced with earnings *before* depreciation sufficient to absorb *part only* of the usual depreciation charges charge the full amounts?

The answer is indicated on Table II.

TABLE II

Depreciation Policy of 25 Companies Whose Earnings Before Depreciation Were Insufficient to Absorb Full Depreciation

No. of Co.'s		*Earnings Before Depreciation*		*Depreciation*	
		1937	*1938*	*1937*	*1938*
	Depreciation Policy	'000	'000	'000	'000
4	Charged ½ or less of 1937 charges	1,240	226	1,035	494
3	Charged full amount of earnings *before* depreciation	9,127	5,582	9,439	5,582
3	Charged between 50% and 85% of 1937 charges	1,408	908	947	786
15	Charged 100% of 1937 charges	3,324	1,525	2,293	2,290

The same pattern is revealed here as in Table I. Forty per cent of the 25 companies reduced their depreciation charges on finding their earnings *before* depreciation to be insufficient to absorb the previously established charges. On the other hand 15 companies (60%) continued to book the full charges, thereby recording net losses.

On the basis of the evidence of Tables I and II it is reasonable to conclude that if not half, then at least a very substantial minority of Canadian companies will discard the consistent use of the same rates of depreciation where net income falls and the exigencies of taxation do not require the maintenance of full depreciation charges. These companies will book depreciation in the light of the earnings available for its absorption. Discussion of the reasons for this is beyond the scope of this study.

SOME TAX CALCULATIONS

By C. J. Hunter, Chartered Accountant, Toronto

Inventory Reserve—Section 6

The provision for inventory reserve can be deducted from the income of a company taxable under the second part of the second schedule. If the provision is sufficiently large, the income will be reduced to the point where tax under the first part equals tax under the second part. This determines an upper limit for the inventory reserve provision found as follows:

let x = income
y = inventory reserve provision
z = standard profits
tax under first part = tax under second part

$$\frac{10}{100}x = \frac{70}{100}(x - y - z)$$

$$60x = 70y + 70z$$

$$y = \frac{6}{7}x - z$$

i.e., upper limit for inventory reserve provision is $\frac{6}{7}$ income—standard profits.

In the same way, working with 1941 rates, upper limit is seen to be $\frac{79}{123}$ income—standard profits.

For working out a company's tax in 1942, the income, inventory reserve provision and standard profits are all apportioned to the two periods on a daily basis. The inventory reserve provision apportioned to the first period may be greater than the upper limit for that period as just determined. In this case the excess not usable in the first period can be used in the second period.

Refundable Portion—Section 18

It is necessary to find the point at which tax under the first part of the second schedule equals tax under the second part.

x = income

y = inventory reserve provision

z = standard profits

$$\frac{10}{100}x = \frac{70}{100}(x - y - z)$$

$$6x = 7(y + z)$$
$$x = \frac{7}{6}(y + z)$$

i.e., income at point referred to in section 18 is $\frac{7}{6}$ (inventory reserve provision + standard profits).

Refundable portion is 20% of [income — $\frac{7}{6}$ (inventory reserve provision + standard profits)].

Note: In this case, y may be a minus quantity.

REFUNDABLE PORTION OF INCOME AND EXCESS PROFITS TAX

The following memo regarding the refundable portion of the 1942 income and excess profits tax is sent to THE CANADIAN CHARTERED ACCOUNTANT by Mr. Albert Hattin, C.P.A., of Hattin and Hattin, Toronto. It was issued to his audit staff for the purpose of adopting a uniform treatment.

With Respect to Personal Income Tax—The refundable portion of the personal income tax need not be shown anywhere on financial statements since it is purely a personal item. It will be in the nature of a non-taxable receipt when refunded and thus be credited to proprietors' capital accounts.

With Respect to Excess Profits Tax—Excess profits tax is levied upon the profits of the business. The refundable portion thus constitutes a deferred business expenditure. It will be refunded to the business upon the happening of certain events and after the lapsing of a certain period of time over all of which the business has no control. The possibility of obtaining the refund is therefore contingent upon world events rather than upon the management and business conditions. It is therefore a contingent deferred asset. The accounting treatment should be as follows:

(a) At time of paying the tax, charge the full amount of the tax including the refundable portion to surplus, or (capital accounts in the case of an unincorporated business).

(b) Show the refundable portion of the tax as a footnote to the balance sheet as follows:

"Contingent Deferred Asset"

Refundable Portion of Excess Profits Tax $20,000

(c) When refunded by the government—it will constitute a tax free receipt and be credited directly to surplus or capital accounts.

A QUESTION ON BALANCE SHEETS

(Edit. Note: Correspondence is invited on this question, which has been submitted by a reader)

THE goal of the accountant is to produce an income account and a balance sheet. A well-reasoned answer is desired to the following question, involving a revised explanation of the science and philosophy of debit and credit, together with a mathematical and accounting example proving the accuracy of the theory.

The Facts: An American balance sheet is drawn up in the form of a statement showing assets, as debit balances, on the left-hand side, and liabilities, as credit balances, on the right-hand side. An English balance sheet is drawn up in the form of a statement showing assets, as credit balances, on the right-hand side, and liabilities, as debit balances, on the left-hand side.

The Question: To reconcile the underlying theory of debit and credit between the two distinct forms of balance sheet. If both forms are correct, show the connecting link between them. If only one form is correct, show why the other form does not destroy the basic equation of the balance sheet, or reverse the common accepted usage of debit and credit. Obviously, this involves the fundamental structure of the double entry system.

Remarks: A number of answers have been given at various times to this question, and they are recorded below in order that they may be rejected at the outset, as they are not the answers required.

1. The usual answer is that the reversal of the order of presentation is merely a mechanical one. This is not so, as a mechanical reversal can be secured by turning over a balance sheet and looking at it from the back. Moreover, some balance sheets are set out in vertical form, but always with assets as debit balances and liabilities as credit balances.

2. Another answer is that although the English balance sheet is reversed in form, it does not change the use of debit and credit, and shows liabilities on the left-hand side as credit balances and assets on the right-hand side as debit balances; or, that a balance sheet is not an account, and that the Dr. and Cr. are not shown at all. This is not an

answer, but constitutes an evasion or a denial of the facts of the question.

The fact is that many English balance sheets, especially those of banks, do show printed headings, namely Dr. above liabilities on the left-hand side, and Cr. above assets on the right-hand side. (As an example of this, see any English balance sheet of Barclay's Bank Limited.) This fact constitutes the question, as otherwise there would be no question.

3. That the custom represents the desire of the conservative Englishman to look for his liabilities first, and to pay what he owes. This answer is facetious. For purposes of the question, the two forms may just as likely be in use by Esquimos and Hottentots respectively.

4. That the English practice was influenced by forms sponsored by parliament in the Companies Act, 1862, and that the authors of that act made an error in their conception of a balance sheet. It is recognized that their act was perfectly logical, and that it is the accounting interpretation of the principles involved which is at fault. It is hardly feasible that this method should have been in use for so many years if it had been fundamentally wrong.

5. That the English form of balance sheet represents the statement of account rendered by the business, as an entity, to the owners. This cannot be the correct conception, as all accounting books state that a balance sheet is not an account, but a statement of condition. Conversely, it would require that the owners render an account to the business.

6. That the balance sheet in the English form represents closing entries for asset and liability accounts, and as such it is a memento of the days when a "balance account" was used. If a "balance account" is used, it would indicate that the two forms of balance sheet are complementary. An account involves a statement between two parties, whereas a balance sheet involves three parties, namely: (a) The debtors; (b) the creditors (including the owners); and (c) the company itself.

7. As a matter of record, this question was asked in a paper for the final examination of the Institute of Bankers, in the following form: "In a list of trial ledger balances, the debits (assets) are entered in the left-hand column,

while the credits (liabilities) appear in the right-hand column—the same order as they do in the ledgers. Some balance sheets however (not all) reverse this order, placing the debits (liabilities) on the left-hand side, and the credits (assets) on the right-hand side. When this course is pursued, explain the reason, in your opinion, for the figures being thus transposed." The answer given was as follows: "Some advocates of the system of placing the liabilities on the left-hand side and the assets on the right-hand side of the balance sheet contend that it is a personal account made out as against the proprietor of the business in question, and that he is therefore 'in credit' to the extent of his assets, and 'in debit' to the extent of his liabilities. On the contrary, it is asserted that a balance sheet is not an account at all, but is, as its name implies, a sheet or summary of balances as abstracted from the ledger, and as a consequence, such balances should appear upon the same side of the sheet as they do in the ledger."

It would seem that there is considerable confusion and doubt in the minds of accountants regarding the application of the basic equation of the balance sheet. An answer should state specifically one of the following findings:

1. The American form is the only correct form.
2. The English form is the only correct form.
3. Both forms are equally correct.

Under whichever heading the answer belongs, a comprehensive practical example is required showing the reason *why*.

(American Form of Balance Sheet)

A. B. C. Co.

Dr. Assets	*Liabilities Cr.*
Debit Balances	Credit Balances

(English Form of Balance Sheet)

A. B. C. Co.

Dr. Liabilities	*Assets Cr.*
Debit Balances	Credit Balances

LEGAL DECISIONS

[*Editor's Note:*—The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports.* In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Income Tax Act (Alta.)—Life insurance on company officer —Premiums paid by company

(re Gillespie)

Alberta Supreme Court, Appellate Division

Where an officer of a company insures his own life, notwithstanding the fact that the company may derive some benefit from the assignment of the policy to a bank to secure a loan for its purposes, the payment of premiums by the company made in consideration of such benefit must be treated as if paid to the officer and to be income received by him as much as if he had been paid the same as part of his salary as an officer. The fact that these were not paid to him but to the insurer makes no difference. They are profit or gain indirectly received during each of the years in which the premiums are so paid within the meaning of the Income Tax Act, 1932 (Alta.), c. 5. The judgment points out that the insurance was taken out by the officer and this was not a case of a corporation insuring the life of its officer in which it has an insurable interest. It would appear that in such later case, in the absence of clear evidence that it was for his benefit, the premiums paid thereon by the corporation would not constitute taxable income of the officer.—[1943] 1 D.L.R. 202.

BOOKLET ON CANADA

"CANADA 1943", a new edition of an annual publication, has been issued by The Dominion Bureau of Statistics, from which it may be obtained at 25 cents per copy. This edition contains 196 pages. It is in the nature of an abridged and popular edition of The Canada Year Book, with numerous illustrations, many of which this year depict wartime activities.

PERSONALS

An announcement has been received to the effect that the partnership heretofore carried on by George F. Glatt and Herbert G. Gordon, under the firm name of George F. Glatt & Company, Toronto, Ontario, is being continued under the name of Glatt and Gordon, chartered accountants. There is no change in partnership.

Jacques LaRue, a member of the Society of Chartered Accountants of the Province of Quebec, announces the opening of an office at 126 St. Peter Street, Quebec, P.Q., for the practice of his profession.

J. E. Lloyd, chartered accountant, of Halifax, Nova Scotia, has been elected mayor of the City of Halifax.

Messrs. S. S. Feiner and D. Finestone, chartered accountants, Montreal, announce that they are practising under the firm name of S. S. Feiner & Company.

R. Donald Pearson, a member of the Society of Chartered Accountants of the Province of Quebec, has opened an office for the practice of his profession as a chartered accountant at the Canadian Bank of Commerce Building, 1414 Crescent Street, Montreal, P.Q.

Messrs. Maurice Chartre, Maurice Samson, A. Emile Beauvais, Jean-Paul Gauthier, E. Harry Knight, Leon Cote and Gerard Marceau, chartered accountants, announce the admission into partnership of Paul Trudel, chartered accountant. They will practice their profession under the firm name of Chartre, Samson, Beauvais, Gauthier & Cie, chartered accountants, with offices at Montreal, Quebec and Rouyn.

OBITUARY

The Late Charles Alfred Legendre

The Society of Chartered Accountants of the Province of Quebec announces with deep regret the death of Charles Alfred Legendre on Good Friday, at the age of thirty-six, after a lengthy illness.

A son of Alfred Legendre of Quebec City, Mr. Legendre studied at the Quebec Commercial Academy and McGill University, Montreal, and was admitted to membership in December 1938, after passing the final examination. He served his apprenticeship with McDonald, Currie & Company and for the past few years had been connected with the Montreal office of that firm.

To his father and sisters, the members extend their sincere sympathy.

"MANAGERIAL CONTROL THROUGH INTERNAL AUDITING"

La Salle Extension University, Chicago, Ill., has issued a 55 page booklet entitled "Managerial Control Through Internal Auditing", by Victor Z. Brink, Ph.D., C.P.A., Research Director of The Institute of Internal Auditors. It deals with functions and purposes of the internal auditor, and his place in the industrial organization, though there are also a number of references to his particular tasks. The following summary definition of internal auditing is provided: "The organized activity on the part of the management to assure itself of proper adherence to company procedures and policies, and to secure the benefits of a systematic and objective verification and constructive analysis and appraisal of the accounting, financial, and other aspects of the company's operations." The author takes the view that the internal auditor is a company man, responsible to the management, independent of the accounting system itself, and also in a position to co-operate with rather than duplicate the work of the independent public accountant.

NATIONAL DEFENCE TAX REFUNDS

The Treasury Board has adopted the following regulation, approved by order in council 7th April 1943:

"The Board recommend that the period provided in subsection 19 of Section 91 of the Income War Tax Act for the making of application for refund of National Defence Tax, being twelve months from the close of the calendar year in which the amount was deducted, be extended to eighteen months from the close of the calendar year in which the amount was deducted."

AIR FORCE OFFICERS COMPLETE LENGTHY TRIP

A seventy-four day journey of over 30,000 miles by air, reaching from below the equator, in the Belgian Congo, in the south, to India in the east, and to Iceland in the north, has been completed by Air Vice Marshal K. G. Nairn, who is a member of the British Columbia Institute of Chartered Accountants, and by Squadron Leader R. E. Waller, who is a member of the Ontario Institute. The trip was chiefly for the purpose of carrying out a plan announced in February by Prime Minister King, providing for Canadian pay for Royal Canadian Air Force personnel, no matter where they may be serving overseas.

TABLE OF EXCHANGE RATES

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	30th April 1943	*15th May 1943*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	443	443
British West Indies—Dollars	9270	9270
India—Rupees	3356	3356
Hong Kong—Dollars (Custodian rate)	2781	2781
Straits Settlements—Dollars (Custodian rate)	5226	5226
Sweden—Kronor	2635	2635
Switzerland—Francs	2569	2569

Note: The above currencies are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

CHARTERED ACCOUNTANTS' CLUB OF OTTAWA

By E. Fricker, Chartered Accountant, Ottawa

At a meeting of The Chartered Accountants' Club of Ottawa held on 17th May 1943 the following officers were elected for the ensuing year: President, B. A. Armstrong, Denison and Armstrong; Vice-President, H. H. Milburn, Income Tax Division; Secretary, J. McCay, Davis Boyce & Company; Treasurer, H. L. Slater, Wartime Prices and Trade Board; H. A. Black, Treasurer, Munitions and Supply; A. C. Brittain, Gatineau Power Company; E. Fricker, Bank of Canada; D. F. Wilson, Foreign Exchange Control Board.

The heartiest congratulations and thanks are due to the chartered accountants' group of the Professional Institute of the Civil Service who, realizing the large influx of chartered accountants to Ottawa to assist in the country's war effort initiated this new additional club for the sake of the wider opportunities of fellowship, co-operation and common interests.

The first and most difficult year has just closed under the enterprising leadership of Mr. A. O. Adamson of the Auditor-General's Department supported by an enthusiastic committee. A membership of nearly one hundred was reached out of an estimated potential of one hundred and fifty. A number of interesting and enjoyable meetings were held, the highlight of which was a dinner in honour of Kris A. Mapp, President of our Dominion Association.

We hope it is a good omen that the new committee met together within an hour after their election and spent the rest of the evening on plans for the coming year.

CHARTERED ACCOUNTANT REPORTED MISSING

The Institute of Chartered Accountants of Ontario reports that in the R. C. A. F. casualty list of 2nd May 1943 John Stanley Renouf was reported missing after air operations. Mr. Renouf came to Ontario after receiving his degree in Saskatchewan and was affiliated with this Institute on 1st June 1940. He was employed with J. P. Langley & Company. The following year he joined the Royal Canadian Air Force. To date no further word has been received of him.

GLIMPSES OF CURRENT ACCOUNTING LITERATURE

A Summary Prepared by John Douglas Campbell, Chartered Accountant

BULLETINS

Cost Accounting

Bulletin No. 15, Volume XXIV, 1st April 1943, published by the National Association of Cost Accountants (385 Madison Avenue, New York) carries two articles which are of current interest. One article covers the field of company administration whereas the other refers to the more specialized field of cost interpretation.

Impact of Federal Taxes—John W. Hooper in the article "Impact of Federal Taxes on the Earnings of Business Corporations" presents a general survey of the results arising from the impact of corporation taxes on the earnings of the business corporation pointing out specifically the fact that as present taxes are "devouring the earnings and the financial reserves of the respective businesses there is a grave necessity for equitable tax treatment for corporations if the present business system . . . . is to survive."

The part which management can and has played in clearly indicating to the administrators as to the relative effects of taxes imposed is clearly set out. Special attention is focused on the recent relief provisions for corporations which have been incorporated in the 1942 Revenue Act (U.S.) which embodies "a very large majority of the legislative provisions sought by the spokesmen for business."

Certain specific problems arising from the present tax situation are discussed in support of the general contention that an intelligent understanding of the principles underlying the tax laws is necessary on the part of management in order that a clear presentation of the problems of business may be presented to the administration. Among the problems discussed are corporate taxes as costs, taxes and the maintenance of dividends, taxes and the maintenance of working capital, taxes and depreciation, carry-backward and post war refunds, need for post war reserves, capital gains and losses, special amortization, relief under abnormal situations, and the use of the last in first out inventory method.

In covering the question of dividends, the likelihood of

impairment, particularly in respect to preferred dividends under the present heavy corporation tax imposts, is stressed. The 1942 Revenue Act provisions (U.S.) applying to utilities covering this situation are set out, under which an amount of taxable income equivalent to the dividends paid on the preferred stock is exempt in part from the total taxes otherwise payable. This is the first indication that dividends on preferred stock are recognized on an equal footing to interest on borrowed capital in the determination of taxable income.

Cost Definitions—Moore C. McIntosh in an article "Government Policies in Cost Definitions under Cost-Plus-Fixed Fee Contracts" discusses U.S. government policies with respect to definitions of costs under CPFF contracts and provides up-to-date information on recent cost interpretations and sources of information.

Bulletin No. 16, Volume XXIV, 15th April 1943, carries two articles dealing with the application of both standard costs and specialized cost systems to specific cases.

Standard Costs—Aircraft—Harry C. Nichols in "Application of Standard costs to the Aircraft Industry" outlines the mechanics, supported by exhibits, by means of which standard parts costs may be applied in developing a job cost controlled system adaptable to the aircraft industry.

"We have found that the value of the data secured and the saving in costs have justified it as being an approach to a more satisfactory cost accounting procedure in the aircraft industry."

Cost System—Forward Pricing—Norman H. Ball in "Cost Systems for Contracts with Forward Pricing Articles" outlines the degree of detail required in respect to contracts which desire to qualify under the specific section of the 1942 Revenue Act (U.S.) which "provides for periodic readjustment of the contract price and exemption for specified periods from renegotiation."

Proration Basis—Section III Volume XXIV, No. 16 presents the second in the series of three research reports. The topic covered is "Practice in Accounting for Non-Recurring Expenditures arising from Wartime Production."

As the majority of expenditures considered are of a war time nature, the companies reporting were either exclusively or partially concerned with war work. The question-

naire sought to ascertain mainly whether the expenditures considered were being spread over more than a single period and whether or not such costs were being charged to specific contracts or were being spread through overhead over total production.

Nine classes of expenditures are considered, namely: Original costs of installing or replacing fences, guard houses and other protective installations; expenditure to provide space, desks and other facilities for government inspectors, auditors etc.; original cost of facilities for added employee training; original cost of providing facilities for women workers; cost of rearranging equipment and converting to war contract production when not specifically allowed by contract; so called "expendable" items acquired in connection with facilities contracts but not capitalizable under government regulations; expenditures for war product research as distinguished from development; cost of engineering, drafting and designing on products being produced under war contracts; original cost of special patterns, molds, dies, jigs, tools and machinery fixtures required for war contract production.

Although there was no distinct division in the case of any of the questions as to deferment the governing factor was essentially the nature of the expenditure. Whereas the general tendency was to spread the cost of providing facilities for women workers over more than the current period, there was a distinct tendency to charge the original cost of facilities provided for added employee training to the current period.

With the exception of specific expenditures which could be allocated readily to particular contracts, the general tendency was to spread the charges through the medium of factory overhead. The deviations from the general policy are discussed in the case of each of the questions considered.

ARTICLES

(1) Accounting Statements

Chester Martin in an article "Do We Need a Balance Sheet" published in the April 1943 issue of *The Journal of Accountancy* (13 East 41st Street, New York) raises the question as to whether or not the standardized form of balance sheet fulfills the purpose for which it is presented

and if not whether a possible "compromise" would not be more acceptable both from the standpoint of the stockholders, the creditors or other interested parties.

The 'compromise' as outlined consists of four statements described tentatively as results of operations, statement of current accounts, statement of deferred costs and statement and penalty provisions, this same legal aspect is ary balance sheet is broken down into three subdivisions, namely, current, fixed and ownership interest, which are in turn placed in a subordinate position to the operating or 'results of operation' statement. The utilization of comparative information of the previous year provides for the incorporation of information which would ordinarily appear in the source and application of working capital statement.

(2) Excess Profits

Merle H. Miller in an article "Relief Provisions of the New Excess Profits Tax Act" published in the April 1943 issue of *Taxes—The Tax Magazine* presents an extensive treatise of those provisions which have been inserted in the 1942 Revenue Act (U.S.) to perform the same functions of relief as the Board of Referees perform in the case of the operation of the relief provisions under the Canadian Excess Profits Tax Act.

Although the Canadian system held a relatively strong appeal to those drafting the U.S. relief provisions a greater need for uniformity was desired due to the larger number of cases involved and thus certain broad standards were established to indicate in general the types of situations under which relief would be granted. A descriptive review of the various relief provisions is presented under the following subdivisions: Production interrupted by physical or temporary economic causes; companies having different business cycles; sporadic periods of production; change in the character of the business; new businesses and other factors.

A detailed discussion of the above 'relief provisions' is also presented under the heading "General Relief Provisions of the Excess Profits Tax" by Thomas M. Wilkins published in the April 1943 issue of *The Journal of Accountancy*.

(3) Accounting in Price Control

Charles W. Lamden in an article "The Place of Accounting in Price Control" published in the January 1943 issue

of *The Accounting Review* (University of Michigan, Ann Arbor, Michigan) sets out clearly the exact place of accounting in the present governmental set up of controls with particular reference to the question of price control.

Although the legal aspect is significant in that it presents "the regulations, the directives and the boundaries within which the control must operate" plus the enforcement and penalty provisions, the same legal aspect is "couched in accounting terms and the administration of the control within the boundaries of the law as well as the evidence of compliance with or violation of the law are based on accounting and accounting procedures."

The major portion of the article is devoted to a running commentary covering the highlights of the present price control legislation and its operations in the United States. The survey is drafted in such a way as to bring to the fore the part played by accounting in the operation of such price control. "In supervising the allocation of costs and the determination of prices, the government steps into the operation of every business, and accounting becomes the mechanism of control."

(4) British vs. American Taxes

H. Arnold Strangman in an article "British and American Taxes" appearing in *Taxes—The Tax Magazine* April 1943 (Commerce Clearing House—214 N. Michigan Ave., Chicago) presents a generalized picture of the divergence in principles with special attention to those differences which do "much to nullify any attempt to make comparisons between the two countries at least in so far as income tax is concerned."

In outlining the major variances the questions of taxation of capital gains and losses, taxation of the rental value of owned and occupied real estate, state taxation, double taxation of dividends, rates and allowances coupled with their significance in respect to attendant price levels and the existence of tax free securities, are discussed.

BOOK REVIEW

Introduction to Accounting for Students of Economics—C. A. Ashley (Toronto and London: The University of Toronto Press and the Oxford University Press, 1942, Pp. 136, $1.50).

"The purpose of this book is to present as concisely as

is compatible with understanding the methods and conventions used by accountants; with some discussion of their limitation from the point of view of the economist."

Written by an accountant this text presents a clear elementary statement of the techique of double entry accounts based on a journal entry approach. The general presentation is interspersed with contact points where certain conventions of accounting which are of special interest to economists are enlarged upon.

The points of liaison are evidenced covering the accounting conventions of depreciation, inventory valuation and cost accounting.

In covering the question of the utilization of the depreciation fund the relative effect of the unexpended depreciation is carefully considered from the standpoint of the economy of the country as a whole. "The management of the business may not be fully conscious of the effects of their policy, which may be followed whether or not an increase in investment in the business is wise at a time it is made out of funds retained as reserve for depreciation . . . . the investment takes place without passing the test of the capital market."

In discussing the general question of cost accounting stress is placed on the use of the marginal cost concept of the economist as against the average and standard cost concept of the accountant from the standpoint of usefulness in such a field as fixing of sale prices of specific goods and services. The implication that accounting has fallen short in its failure to measure marginal costs is presented with the added suggestion that businessmen are frequently misled by the accounting concepts of average and standard costs and therefore have not always acted in accordance with the tenets of economic theory.

From the standpoint of accounting the text is elementary, being designed primarily for students who are coming in contact with the subject for the first time. From the standpoint of economics it presupposes an underlying background of economics which is absolutely necessary to fully appreciate the points of contact which are discussed. In other words this textbook, although it tends towards a questionable stress on the technical details of keeping the accounting records, appears to fulfill the purpose for which it is designed.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

We have received the 1943 issue of *The Commerce Journal*, the annual review published by the University of Toronto Commerce Club, and we cannot refrain from quoting from the foreword written by Dr. H. A. Innis. "The mechanism of tanks and aeroplanes which became important toward the end of the last war have become the rule in this. The last war was not a respecter of persons; this war is organized around a hierarchy of capacity and training on the military and civil fronts. Industry and intelligence at home mean the saving of life abroad. In the last war the universities were drained; in this war they are filled to capacity. While echoes of the last war are still carried by remnants of an older generation, it has gradually become firmly established that the universities have become the spearhead of mechanized warfare. Skill and equipment have become the essence of modern warfare on the military and civil fronts." And finally: "One lesson above all was burned into our minds in the last war, and this we can pass on to you and attempt to apply it to the home front which is in sad need of it during a long war. Always that lesson was steadiness, steadiness, steadiness."

* * *

For the greater part this issue of *The Commerce Journal* consists of articles based on a series of lectures on "Marketing and Business Trends Looking Into the Post-War Era." On the purely accounting side there is a cogent plea by Professor C. A. Ashley for uniformity in the presentation of accounting statements, buttressed by quotations garnered from a wide field but all revealing a sense of dissatisfaction with existing conditions. The author's specific recommendations are twofold, first, the acceptance of identical terminology in all published accounts for things which are identical in their essential characteristics, second, the devising of appropriate forms and standards for the published accounts of different types of commercial and industrial enterprises (to replace the general form prescribed by the companies acts). "*The Economist*" says Professor

Ashley "recently published an article containing a vigorous attack on accounting methods, and it is a sane journal with a large following. 'The desirable approach to the problem is that representatives of industry should agree among themselves to a standard form of accounts, which would give the public the required facts' (26th September 1942)." Those of our readers who are endowed with a critical faculty and progressive instincts would find this essay most stimulating.

* * *

Professor Paton and others have from time to time prepared simple hypothetical illustrations contrasting the effect upon reported income of different methods of inventory valuation. Mr. Charles J. Gaa who is with the Accounting Division of the Office of Price Administration has now made a more elaborate study of the effect of the "first-in, first-out" and "last in, first-out" methods upon the calculation of profits and upon income taxes (U.S.A.) payable.[1] His illustrations (general manufacturing, retailing, tanning, and bituminous coal mining) though much more complete than anything attempted before, are still hypothetical ones but he has exercised great ingenuity in developing a set of figures reflecting the relative changes which occurred in the business cycle of 1919-1937 in the volume and price of goods sold, goods acquired, volume of inventories, etc. To the resultant calculations of profit the actual rates of income taxes in effect each year have been applied. Some of the conclusions reached by Mr. Gaa are that under "Lifo" (last-in, first-out) inventories and profits are more stable than under "Fifo" (first-in, first-out), there being "a levelling off of the net income peaks and a filling in of the valleys", and that for the entire period covered for all industries "Lifo" resulted in the largest amount of income tax payable. "Lifo" also resulted in the greatest *burden* of tax payable in that it involved relatively greater taxes than did "Fifo" in depression years—years in which the sacrifice of making tax payments is greater than in years of prosperity.

[1]Charles J. Gaa, *Effect of Inventory Methods on Calculation of Profits and Income Taxes* (University of Illinois, Bulletin No. 25, Vol. 40, pp. 66).

STUDENT ASSOCIATION NOTES

Ontario Students Missing

The Chartered Acountants Students' Association of Ontario regrets to report that Flt. Sgt. D. L. Jarrett and Sgt. Pilot G. K. Smallwood have both been reported missing after air operations overseas. Flt. Sgt. Jarrett was employed with Mr. S. R. Brunton, chartered accountant, of Sudbury, while Sgt. Pilot Smallwood was with Mr. H. C. Brown, chartered accountant, of Toronto. Both of them were students in the first year and had not written any Institute examinations.

* * *

Death of Quebec Society Student

The Chartered Accountants Students' Society of the Province of Quebec records with deep regret the death of Douglas (Tim) Saville Robinson, on Sunday, 16th May, at the age of twenty-one years. Born in Yorkshire, England, Tim was the son of Captain H. F. N. Robinson, British Army, and of Mrs. Robinson of Yorkshire, England. He came to Canada in 1939 for a holiday and war preventing his return, he entered the employ of Riddell, Stead, Graham & Hutchison, and attended the classes at McGill University with a view to obtaining his degree of chartered accountant. He passed three intermediate class examinations with first class honours. To his parents the members extend their deepest sympathy in a more than usually sad bereavement.

* * *

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1942

Accounting I, Question 1 (20 marks)

(a) Define the following terms as used and understood in higher accounting:

(i) Depreciation
(ii) Depletion
(iii) Obsolescence
(iv) Amortisation

(b) Discuss briefly any inter-relationship of the terms.

(c) Name and describe briefly three methods of computing annual provision for depreciation.

SOLUTION

(a) (i) By the term "depreciation" is understood the diminution in service or physical value of an asset, caused by wear and tear, weather, obsolescence, etc.

(a) (ii) "Depletion" implies the reducing or using up of natural resources such as those of mines, oil wells, forests, etc. It differs from depreciation in that depreciation applies to diminution in value caused by use or through the effects of elements and time, whereas depletion is a reduction in quantity caused by consumption or waste.

(a) (iii) By "obsolescence" is meant the condition of becoming out-of-date or useless; e.g., the diminution in the value of machinery and plant resulting from new discoveries and improvements, rendering existing equipment uneconomical for operation. It also implies the diminution in the value of merchandise and materials resulting from changes in consumer demand or utility.

(a) (iv) "Amortization"—literally, gradual death. Used in accounting to express the gradual extinguishment of intangible accounts included among asset values over a period of time usually related to each particular item, e.g., premium on lease, discount and costs of bond issue, costs of patents. The term amortization is not usually applied to the writing-off of tangible asset values, the accepted term for which is depreciation.

(b) It will be noticed from the foregoing that while the terms depreciation, depletion and amortization mean the extinguishment of asset values, each from a distinctive cause, the word "obsolescence" implies a loss of value which is one of the causes of "depreciation".

(c) Any three of the following:

(i) Straight line—a percentage of original cost based on the estimated life of the asset, taken annually or at other regular equal periods.

(ii) Diminishing (or reducing balance)—A method by which a constant percentage of the balance is annually written off the asset value, thus periodically reducing the balance of the account.

(iii) Sinking Fund—A method based on the presumption that a sum of money equal to the amount of the annual provision for depreciation will be invested so that the accumulated sums with the income from its investment will be equal to the cost of the asset at the end of its useful life.

(iv) Annuity—The provision of an equal annual charge which not only takes up the cost of the asset during its useful life but allows for interest on the money remaining sunk in the asset.

(v) Production (or working hours)—Depreciation provided on the basis of the use of the asset—a fixed rate per hour for machines, per mile for automobiles, etc.

[Editor's Note: For a full explanation and discussion of the annuity and sinking fund methods of depreciation the reader might refer to Finney, Principles of Accounting, Vol. I, pp. 275-278.]

PROBLEM II

FINAL EXAMINATION, DECEMBER 1942

Accounting II, Question 2 (25 marks)

The Nonsuch Company Limited manufactures a product known as XX based on a monthly production of 350 units in 7,700 hours of operation. The standard factory expenses based on the company's budget is $5,390.

The following is a summary of the standard unit cost of product XX:

Materials—30 pieces—A	$18.00	
Materials—20 pieces—B	10.00	
		$28.00
Labour—22 hours		13.20
Factory expense—22 hours		15.40
		$56.60

The following is a summary of the transactions for the month of November 1942:

Materials	Purchased	Purchase value	Requisitioned out of stores
A	12,000 pieces	$8,400	10,800 pieces
B	8,200 pieces	$3,280	6,600 pieces

Labour as per payrolls:

Direct	7,600 hours	$4,940
Indirect	600 hours	$ 312
Factory expense		$4,885

Production for the month of November was 325 units of XX.

There was no work in process or raw materials Inventory as at 31st October 1942, but work in process at 30th November 1942, was as follows: 24 units of XX in the following state:

Material one half supplied.
Labour one quarter applied.

Selling and administrative expenses for the month amounted to $2,500.

Sales—300 units of XX at $70—$21,000.

Required:

(a) Journal entries to set up necessary routine entries and *all* variation accounts which might be applied to the manufacture of product XX. Give full explanations.

(b) Profit and loss statement for the month of November 1942.

SOLUTION

(a) *Journal Entries at 30th November 1942*

Materials A—$8,400.00 B—$3,280.00	$11,680.00	
To Accounts payable		$11,680.00
To record materials purchased during November		
Factory expense in process	4,885.00	
To Accounts payable		4,885.00
To record factory services purchased during November.		
Materials in process	$10,200.00	
To Materials		$10,200.00

To record actual cost of materials used during the month as per requisitions:—

10,800 pieces of A	$.70	$ 7,560.00
6,600 pieces of B	.40	2,640.00
		$10,200.00

Labour in process		4,940.00	
Factory expense in process		312.00	
To Accrued payroll			5,252.00
Direct: 7,600 hours @ $.65	$4,940.00		
Indirect: 600 hours @ .52	312.00		
	$5,252.00		

To record actual amounts as per labour payroll summaries.

Finished goods	18,395.00	
To Materials in process		9,100.00
Labour in process		4,290.00
Factory expense in process		5,005.00

To record standard cost of product "X" completed during the month (325 units) as follows:

Element	Per Unit	Amount
Material	$28.00	$ 9,100.00
Labour	13.20	4,290.00
Factory expense	15.40	5,005.00
Total	$56.60	$18,395.00

Work in process clearing account	507.60	
To Materials in process		336.00
Labour in process		79.20
Factory expense in process		92.40

To record closing inventory of work in process at standard.

Element	Units	Per Unit	Amount
Materials	12	$28.00	$336.00
Labour	6	13.20	79.20
Factory Expense	6	15.40	92.40
			$507.60

Since there are 24 units of A in process the following situation would exist:

	Degree Complete	No. of Units	Equivalent in Finished Units
Materials	½	24	12
Labour	¼	24	6
Factory expense	¼	24	6

The above entry is reversed later.

Costs of goods sold	$16,980.00	
To Finished goods		$16,980.00

To record the standard cost of goods sold during the month (300 x $56.60)

Accounts receivable	21,000.00	
To Sales		21,000.00

To record sales for the month of November (300 x $70.00)

Selling and administrative expenses	2,500.00	
To Accounts payable		2,500.00

To set up sundry selling and administration expenses.

Variation from standard quantity	344.00	
To Materials in process		344.00

To set up net cost of materials wasted at standard.

Particulars	A	B	
Actual pieces as per requisitions	10,800	6,600	
Standard pieces:			
337 x 30	10,110		
337 x 20		6,740	
Pieces saved ($.50)		140	$ 70.00
Pieces wasted ($.60) ..	690		414.00
Net cost of waste at standard			$344.00

Variation from standard material price	420.00	
To Materials in process		420.00

To record variation from standard price as set for materials used.

Part	Number of Pieces	Actual Price	Standard Price	Amount	
A	10,800	$.70		$7,560.00	
	10,800		$.60	6,480.00	$ 1,080.00
B	6,600	$.40		2,640.00	
	6,600		$.50	3,300.00	660.00 Cr.
			Loss based on standard		$ 420.00

Variation from standard labour time	190.80	
To Labour in process		190.80

To record variation from standard labour cost due to time factor.

Actual hours per payroll	7,600
Standard hours—based on completed inventory units (331 x 22)	7,282
	318
Standard labour rate	.60
	$190.80

Variation from standard labour rates	$ 380.00	
To Labour in process		$ 380.00

To record variation from standard due to rate factor.

Actual hours	Actual rate	Standard Rate	Amount
7,600	$.65		$4,940.00

7,600	$.60	4,560.00		
		$ 380.00		

Factory expense in process		193.00	
To Variation from standard factory expense budget			193.00
To record saving in actual factory expense over budget for November.			
Budget	$5,390.00		
Actual factory expense	5,197.00		
	$ 193.00		
Idle time		70.00	
To Factory expense in process			70.00
To record factory expense cost of idle time for November.			
Budget standard hours	7.700		
Actual hours per payroll	7,600		
Idle time	100		
Standard rate per hour	.70		
	$70.00		
Variation from standard factory expense—quantity		222.60	
To Factory expense in process			222.60
Excess of actual over standard hours for month's production	318		
Factory expense rate per hour	.70		
	$222.60		
Materials in process		336.00	
Labour in process		79.20	
Factory expense in process		92.40	
To work in process clearing account			507.60
To record work in process inventories in accounts at standard cost.			

(b) NONSUCH MANUFACTURING COMPANY LIMITED

Statement of Profit & Loss for the Month Ended 30th November 1942.

Sales		$21,000.00
Standard cost of goods sold		16,980.00
Gross profit on sales		4,020.00
Selling and administration expenses		2,500.00
Net profit on sales		1,520.00
Less: Net variation from standard cost of production		
Excess materials used over standard	$344.00	
Excess paid for material over standard	420.00	
Excess labour hours used over standard	190.80	
Excess in labour rates over standard	380.00	

Saving in factory expense over standard..	Cr. 193.00	
Idle time	70.00	
Excess factory expenses used over standard	222.60	1,434.40
Net profit		$ 85.60

Note: The foregoing calculation of profit is based on a valuation of work in process and finished goods at standard cost.

THE

CANADIAN CHARTERED ACCOUNTANT

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OF

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